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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Israel's Economic Situation: Strengths and Problems

Secret

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December 1971

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
December 1971

INTELLIGENCE MEMORANDUM

ISRAEL'S ECONOMIC SITUATION: STRENGTHS AND PROBLEMS

Introduction

1. On the surface, Israel's economic situation manifests some impressive strengths. The economy is expanding briskly under conditions of full employment, and reserves of gold and foreign exchange have risen sharply since the first of the year. Beneath the surface, however, are weaknesses that portend future difficulty. Reserves have been boosted by temporary factors, and inflation is undermining the balance-of-payments position and stimulating a scramble for economic advantage.

Discussion

2. Israel will finish 1971 in better balance-of-payments condition than had been anticipated. According to the Bank of Israel, foreign exchange reserves were nearly $675 million at the end of October, or some $250 million more than at the end of 1970. [redacted] 25X1

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3. Merchandise exports were 24% greater in the first ten months of 1971 than in the comparable portion of 1970, whereas a year-to-year increase of only 14% had been officially forecast. Imports were up 24% also, but a large share of the increase was accounted for by imports of civilian ships and aircraft -- for example, oil tankers and Boeing jets -- for which favorable long-term financing was arranged. Earnings from tourism and international transport services benefited from a 38% increase in tourist visits during the first three-quarters of 1971 compared with the same period

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Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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in 1970. Capital inflow accelerated after the August devaluation. Through August, sales of concessionary development bonds were running 40% ahead of a year earlier, and private contributions also appear to have increased. Meanwhile, assistance from the US government has played an important role. In addition to PL 480 assistance and Export-Import Bank loans, Israel utilized military credits totaling $235 million in 1971 (the residue of $500 million in military credits extended in US fiscal year 1971).

4. Israel's economic situation, however, has serious weaknesses. Perhaps the most basic of these is overheating of the domestic economy. Unemployment appears to be at an irreducible minimum, and some 45,000 residents of the occupied territories are employed in Israel. Prices rose 10% in 1970 and another 10% in the first ten months of this year. Government spending has increased faster than was anticipated in the budget, fueled by I£1.2 billion in borrowing from the Bank of Israel over the first ten months of 1971.* The budget had authorized such borrowing at an annual rate of only I£650 million in the fiscal years ending 31 March 1971 and 31 March 1972, and even this rate would have been inflationary in Israel's full employment situation. Inflation is eroding the advantages gained in devaluation of the pound from $0.286 to $0.238 on 21 August.

5. In conjunction with fading of the external threat to security during a year of ceasefire, inflation also has eroded the social cohesion of Jewish Israelis and fostered the re-emergence of individual and group interests. Per capita private consumption has risen by one-fifth since the war, and Israelis want more of the same; but continued progress is threatened, most obviously by inflation. Despite government efforts to enforce an incomes policy, workers in the private sector have succeeded in obtaining wage hikes both over and under the table, and employees of the government and of public organizations have resorted to strikes and similar measures in an effort to keep pace. Negotiations now are in progress among representatives of labor, management, and government on a new round of wage agreements, and labor is showing little interest in moderation.

6. Shifting public attitudes also have been apparent in discussions and actions involving the government budget for the fiscal year beginning 1 April 1972. The pressure is great for increased spending, particularly for social welfare measures, but tax increases appear to be unacceptable either to the general public or to the government. Finance Minister Sapir has estimated government revenues for the coming fiscal year at I£15.25 billion and imposed a ceiling on expenditures of I£16.25 billion. The expenditure requests of the various ministries, however, total I£19.5 billion, including I£6 billion for defense. Sapir thus has demanded sizable cuts in budget

* *The present exchange rate is I£4.2 = $1.*

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requests and apparently has worked behind the scenes to reduce the defense request. Proposed defense outlays are being questioned within and without the government for the first time since the Six-Day War, and a reduction in defense spending in real terms is a distinct possibility. Defense Minister Dayan claims, however, to have trimmed his ministry's request I£500 million below its original level and eliminated all nonessential outlays before its formal submission. The defense request now has been referred for scrutiny to a three-member cabinet committee headed by Prime Minister Meir. Sapir has announced that the government will present the budget to the Knesset in February rather than in early January as is customary, apparently because of the struggle to achieve sizable but rational reductions.

7. The recent export surge cannot be regarded as the beginning of a trend, because inflation is undermining Israel's competitive position and also because exports received a great deal of impetus from unsustainable increases in sales of diamonds and citrus fruit. Diamond sales have been rebounding from a decline in 1970 that was caused by recession in the United States. Not only are retail sales of diamonds recovering in 1971, but inventories apparently are being rebuilt by American dealers. Citrus exports benefited from the combination of record output and a price rise in Europe resulting from weather damage to the Spanish citrus crop. Industrial exports also benefited from the record citrus crop because processed food products are carried in this category.

8. Perhaps $50 million of the increase in Israel's reserves was a windfall gain resulting from the concentration of reserves in West German marks. As the mark floated upward this year, the dollar value of Israeli reserves rose accordingly.

9. Foreign indebtedness now exceeds $1,000 per capita and is rising. Although most foreign debt is long-term and much of it concessionary, debt service will cost Israel about $500 million this year. Thus debt service constitutes a heavy burden, absorbing about 30% of the foreign exchange earned by exports of goods and services.

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